

VZCZCXYZ0000
RR RUEHWEB

DE RUEHTA #0522 0770835
ZNY CCCCC ZZH
R 170835Z MAR 08
FM AMEMBASSY ASTANA
TO RUEHC/SECSTATE WASHDC 2013
INFO RUCNCIS/CIS COLLECTIVE 0438
RHEBAAA/DEPT OF ENERGY WASHDC
RUCPDOC/DEPT OF COMMERCE WASHDC

C O N F I D E N T I A L ASTANA 000522

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STATE FOR SCA/CEN, EEB

E.O. 12958: DECL: 03/14/2018

TAGS: PGOV PREL EPET KZ

SUBJECT: YUSHCHENKO'S VISIT TO KAZAKHSTAN PAYS NO IMMEDIATE DIVIDENDS IN ENERGY SECTOR

Classified By: AMBASSADOR ORDWAY FOR REASONS 1.4 (B) AND (D)

¶1. (C) Summary: Presidents Yushchenko and Nazarbayev both described Kazakhstan - Ukraine relations as excellent during Yushchenko's March 5-6 visit to Kazakhstan. No agreements were reached, however, on energy cooperation. Instead, President Nazarbayev publicly pronounced that Kazakhstan will not supply oil for the Odessa - Brody pipeline without Russia's consent. After Yushchenko's departure, Ukrainian diplomats in Astana said that prospects are poor for enhanced energy cooperation with Kazakhstan. End Summary

¶2. (SBU) President Yushchenko of Ukraine travelled to Kazakhstan on March 5-6 for a visit timed to coincide with the opening of the "Year of Ukraine" events in Kazakhstan. Yushchenko said that Ukraine is ready to support Kazakhstan in its efforts to promote its political and economic interests in Europe. President Nazarbayev called Ukraine a key political and economic partner and noted that trade increased by 64% between the two countries in 2007. According to Nazarbayev, Kazakhstan is the seventh biggest trade partner of Ukraine globally and the second biggest in the CIS.

¶3. (SBU) Energy cooperation was a clear focus of Yushchenko's trip, and the two presidents signed a joint statement declaring "Kazakhstan and Ukraine plan to expand cooperation in Kazakhstan's oil transportation to European markets and to continue working on the long-term prospects of developing the Odessa-Brody oil pipeline." Beyond the joint statement, however, no concrete arrangements were reached, and President Nazarbayev stated that Kazakhstan cannot supply oil for the Odessa-Brody pipeline without Russian consent. Nazarbayev did offer one glimpse of hope for the future, saying that "there is an alternative way to resolve this issue, and that is to reach the Black Sea via Baku."

¶4. (C) On March 12, Poloff discussed President Yushchenko's trip with Mihail Lugovoy, the head of the Ukrainian Embassy's Trade and Economic Mission and his deputy, Sergey Polishuk. Lugovoy was very pessimistic about Ukraine - Kazakhstan energy relations. Ukraine has no leverage with Kazakhstan, he said, in part because of a lack of investments in the Kazakhstani energy sector. Moreover, Russia is Kazakhstan's closest energy partner. Poloff asked Lugovoy whether Ukraine might benefit from the increases in oil output to occur with Tenghiz expansion and initial production at Kashagan. Lugovoy expressed doubt, saying that Ukraine's "oil relationship with Kazakhstan is poor." Even by 2015, according to Lugovoy, Ukraine will not be receiving oil from Kazakhstan.

¶5. (C) Lugovoy was even more pessimistic about gas. He became very emotional when discussing the recent announcement

by Kazakhstan, Uzbekistan, and Turkmenistan that they intend to sell gas at "European" prices, a plan which he called instigated by Gazprom. Lugovoy said that Ukraine can battle Russia in a gas war, matching price increases with transit tariff increases. With the Central Asian countries, said Lugovoy, Ukraine has no countermeasures and is much more vulnerable. Lugovoy concluded by praising the U.S. for its efforts on energy security issues and criticizing the E.U. countries for their inability to create a unified energy policy.

¶6. (C) Comment: Kazakhstan's downstream ambitions are growing. KMG has already made a series of significant purchases, most notably its acquisition of 75% of Romania's Rompetrol. KMG also remains interested in several refineries in Ukraine. Despite the grim prognosis of Ukrainian diplomats, Kazakhstan will continue to engage with Ukraine, if only to keep all of its downstream options open. End Comment.

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